UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Electrification Administration
Finance Division
St. Louis 2, Missouri

TYPES OF ACCOUNTS

Text No. 4

1. TRANSACTIONS AFFECTING CAPITAL ACCOUNT

This type of transaction consists of:

(a) Withdrawals and additional investments, or contributions by the proprietor, affecting capital directly.
(b) Items of income and expense, affecting capital indirectly.

2. WITHDRAWALS AND CONTRIBUTIONS

Contributions which increase the capital investment are not earned. The owner or proprietor of a business, for example, invests additional capital of $500 cash. The journal entry would be:

		November 12, 1943		Debit		Credit	
		Cash		500	00		
		Tom Brown, Capital				500	00
		Additional capital invested.					

The Cash account is debited because there was an increase of assets and the Capital account is credited because there was an increase of capital investment--the owner's equity.
Withdrawals are decreases of invested or earned capital and consist of cash or other assets which the proprietor from time to time may withdraw from the business for his personal needs. If the proprietor withdraws $75 cash, his capital is reduced by that amount. Capital, therefore, should be debited $75 and Cash should be credited because that particular asset was decreased. The journal entry follows:

		February 28, 1944		Debit		Credit	
		Tom Brown, Capital		75	00		
		Cash				75	00
		Withdrawal of cash by proprietor.					

A similar situation occurs in an electric cooperative when a new consumer contributes his membership fee to increase the assets. The total equity of the members is likewise increased and this is shown in the net worth account titled "Capital Stock - Membership Subscribed." When a member moves from the line and his membership fee is returned to him, both assets and members' equity are decreased.

Transactions involving withdrawals and contributions present no difficult problem. If some asset other than cash is contributed or withdrawn, that particular asset account is debited or credited. Instead of crediting or debiting capital directly for contributions and withdrawals, bookkeepers prefer to open a Personal (or Drawings) account with the proprietor for these changes in capital during the accounting period. The balance of this account is then closed or transferred to the Capital account at the end of the period.

3. FINANCIAL STATEMENTS

One of the chief objectives of accounting is to facilitate the preparation of financial statements, the two most im ortant being the Balance Sheet and the Profit and Loss Statement. The Balance Sheet is a formal statement presenting the financial condition of a business at a specified date. It may be defined as a formal statement of assets, liabilities, and capital taken from a double entry set of books. The Profit and Loss Statement explains the changes in capital from business operations during a given period of time. It summarizes by sources the income and expenses of a business during an accounting period, which may be a month, a year or any fraction thereof.

Given a Balance Sheet at the beginning of the period, a Profit and Loss Statement for the period, and a Balance Sheet at the end of the period, one who is familiar with these statements should be able to obtain a fairly complete picture of any business organization.

The basis for the preparation of financial statements is the accounting records of business data as contained in the general ledger accounts, plus any adjustments that may be necessary at the end of the period. The asset, liability, and capital account balances are shown on the balance sheet, and the changes in capital resulting from business transactions as represented by the income and expense accounts will be reflected on the Profit and Loss Statement.

4. INCOME AND EXPENSE ACCOUNTS

An examination of the books of a small mercantile business will disclose that many of the items relate to income and expenses. In the illustrations in Text No. 3, reference to income and expense was purposely omitted. Since, however, the primary motive of any business is to obtain profits, transactions which tend to bring about that result must be regarded as vitally important.

Of course, such profits in an REA organization are not gained for the purpose of enriching the owners, but to make possible a reduction in the cost of electricity to the consumer members.

Income may be defined as an increase of capital resulting from (1) labor or services rendered or (2) profits from the sales of stock-in-trade. Gains from the sale of land or other investments may also be included.

TYPES OF ACCOUNTS

Text No. 4

An expense may be defined as a decrease of capital incident to business operations. Expenses include every cost that a business incurs in connection with obtaining income. Afew examples will make this clear.

A proprietor pays out cash for salaries in the amount of $40. Since assets are diminished we must credit Cash. What is the debit? Inasmuch as decreases in assets must be of set by an increase of assets, a decrease of liabilities or a decrease of capital, we have three kinds of debits to select from. No asset involved in the balance sheet has been increased; no liability has been decreased. The result, therefore, is a decrease in capital for a service received. One possible way of journalizing this transaction would be:

Capital	$40	
Cash		$40
Amount paid for salaries.		

Other decreases in capital which might be handled in the same manner [illegible] interest, rent, insurance, taxes, etc. Notice [illegible] cases [illegible] part with something of value without any tangible return. The benefit gained is in the nature of services and since services received cannot be treated as assets (property rights) any more than the proprietor's skill, knowledge or health, the only thing that can be done is to reduce capital.

Take another example: A proprietor who operates a store obtains for another company an order of goods and receives a commission of $100 for his services. The commission received is an increase of capital representing income as a result of services rendered. The journal entry could be:

Cash	$100	
Capital		$100
Commission received for order.		

Interest on loans receivable, rental from buildings owned, and dividends received on stock owned are sources of income and may be treated in a similar manner; i.e., capital directly to capital.

The important purpose of the Capital account, however, is to show the net increase or decrease of wealth over a given period of time. It is true that if we debited the proprietor's Capital account for expenses and credited it for income, as above indicated, the net income or net loss for the period could be determined by comparing the balance of the Capital account at the beginning of the period, and taking into consideration any withdrawals or investments of capital. Furthermore, it is true that the ledger would be in balance and the assets, liabilities, and capital would be accurately stated. The serious objection to this procedure is that although the Capital account would show whether the business was making or losing money, it would not show the causes that resulted in net gain or net loss, unless the account were analyzed and all the different items of income and expense classified.

Text No. 4

Obviously, to record all income and expense items in one account would involve an undue amount of time and effort in preparing an analysis. Accounting makes provision for an orderly and self-explanatory procedure by which the bookkeeper debits expense accounts or credits income accounts with appropriate titles indicating the causes of the decreases or increases in capital. Thus, when money was spent for salaries and when commission was received in the previous examples, entries would be:

March 15, 1944	Debit	Credit
Salaries	40.00	
Cash		40.00
Salaries paid for the week		
Cash	100.00	
Commission Income		100.00
Earned on order secured for Blank Co.		

The first entry indicates that capital has been decreased by the amount paid out for salaries; the second, that capital has been increased by the amount of commission received. These are posted to general ledger accounts as indicated.

At the close of an accounting period all the income and expense account balances such as Salaries, Commission Income, Rent, Taxes, Interest, etc. are transferred to an account entitled "Profit and Loss." The Profit and Loss account then discloses a summary of all the income and expense items. This account indicates the effect upon capital of business operations for the period, and the balance is transferred to the Capital account. The entire procedure may be illustrated by diagram as follows:

Tom Brown, Capital

	Balance $1,000
	Net Profit 60

Salaries

$40.00	

Commission Income

	$100

(And other expense accounts showing decrease of capital)

(And other income accounts showing increases of capital)

Profit and Loss

$40	$100

Text No. 4

The student will note as the course progresses that the REA accounting system does not make use of the Profit and Loss Account, but that expense and income accounts are closed directly to capital, or "Earned Surplus" as it is called. A knowledge of the "profit and loss" method is essential, however, because it is a fundamental step which is understood although not employed objectively in the REA accounting system.

The expense and income accounts are known by a number of different names that are descriptive of their true nature and character. Some of these are: temporary capital accounts; economic accounts; accounts; accounts relating to capital; accounts that are part of proprietorship; nominal accounts.

5. REAL AND NOMINAL ACCOUNTS

During the remainder of this course we shall refer to the expense and income accounts as nominal accounts and to the asset, liability, and capital accounts as real accounts. The word "nominal" in an accounting sense is synonymous with temporary. The real accounts such as Cash, Notes Receivable, Mortgage Payable, Capital, etc. indicate real, permanent, and independent assets or liabilities. Nominal accounts, on the other hand, are of a temporary nature and exist only during the accounting period, at the end of which they are transferred or closed to the Profit and Loss summary account. The net balance, whether a profit or loss, is transferred from the Profit and Loss account to the Capital account. The real accounts are also called balance sheet accounts because they always appear in the Balance Sheet; and the nominal accounts are also called the Profit and Loss accounts since they appear in the Profit and Loss Statement. The technical meaning of the words "real" and "nominal" should be understood since these terms are widely used in bookkeeping and accounting practice.

6. MIXED ACCOUNTS

In defining real and nominal accounts we attempted to draw a sharp line of distinction between real accounts (asset, liability, or capital) and nominal accounts (income or expense). In practice, however, it is not so easy to separate accounts into two clearly defined groups--real and nominal. Frequently an account contains data that must be regarded as partly real and partly nominal. Before financial statements can be prepared, these elements must be segregated in order that the real element may be reflected in the Balance Sheet and the nominal element in the Profit and Loss Statement. After the accounts are adjusted, however, they become either real accounts or nominal accounts.

For example, suppose that a merchant rents a store, paying $150 in advance for the right to occupy the building for one month. The journal entry would be:

March 31, 1944	Debit	Credit
Rent	150.00	
Cash		150.00
Payment of rent for month of April.		

Theoretically, the Rent account may be regarded for the time being as an asset account. Inasmuch as the one month's rental privilege is equal in value to the cash paid out, this transaction may be viewed in the first instance as an exchange of assets. Cash goes out and another asset represented by one month's rental privilege is acquired. But as each day passes, a part of the occupancy privilege (asset) expires and at the same time an expense accrues by reason of the service received (use of building). In other words, the nominal element in the account grows from day to day while the real element diminishes in value, although it may not be practicable or expedient to record this fact. By the end of the month all the asset value has been expended and the Rent account becomes a true nominal account. Therefore, at any time between the first and last day of the month, the Rent account becomes a true nominal account. Therefore, at any time between the first and last day of the month, the Rent account contains two elements: unexpired rent (asset) and expired rent (expense). Unexpired rent is the real element and the expired rent is a nominal element. An account, therefore is a mixed account as soon as it begins to reflect two different elements.

Many other accounts reflect mixed elements and are reduced during the period of business operations in the same manner as the Rent account was reduced. The asset value may be completely expended or only partially expended as the result of operations. If partially expended, it will be necessary at the close of an accounting period to reduce the account into its elements by an adjusting entry in order that each element may be transferred to the appropriate account for statement purposes. This characteristic is not confined entirely to asset accounts.

Inasmuch as the books seldom show either strictly nominal accounts or real accounts except immediately after the books are adjusted and closed, it would seem logical to classify accounts as mixed accounts as soon as they begin to disclose both real and nominal elements. However, it is customary for practical purposes to speak of an account as real, or primarily real, if the real element is of greater significance; nominal, or primarily nominal, if the nominal characteristic predominates.

7/ ADDITIONAL GENERAL RULES OF DEBIT AND CREDIT

Increases in expense items are debits because they are in reality decreases of capital, and increases in income are credits because they are in fact increases of capital. The accounting rule of debit and credit, of course, remains unchanged but instead of stating that a certain item is debited because it is an expense and that an expense is a decrease in proprietorship, we may expand the rule by recognizing that expense items are normally debits and income items are normally credits. The general rules of debit and credit may be stated as follows:

DEBIT:		CREDIT:	
	Increases of Assets		Decreases of Assets
	Decreases of Liabilities		Increases of Liabilities
	Decreases of Capital		Increases of Capital
	Expenses		Income
	Deductions from Income		Other Income

Therefore, all asset and expense accounts are:		All liability, capital, and income accounts are:	
Increased on the left side by debits and have debit balances	Decreased on the right side by credits	Decreased on the left side by debits	Increased on the right side by credits and have credit balances

8. ILLUSTRATIVE TRANSACTIONS

The ledger established in the name of Dan Ross((see Text No. 3) discloses only real accounts. No nominal account has yet been opened for the reason that up to January 7 we were dealing entirely with transactions that did not affect capital. The remainder of this text will be devoted to journalizing and posting a series of transactions that do affect capital and will necessitate the establishing of a number of nominal accounts.

9. CASH PURCHASE OF MERCHANDISE

Transaction No. 6

On January 9 merchandise was purchased from Leonard Nelson and Company for $800 cash.

January 9, 1944 (Journal - Page 2)

				Dr.		Cr.	
		Purchases	13	800	00		
		Cash	1			800	00
		Merchandise purchased from Leonard Nelson and Company Invoice No. 673.					

Comment

(a) Dr. INCREASE OF ASSETS
Decrease of Liabilities
Decrease of Capital
Expense
Deduction from Income

Cr. DECREASE OF ASSETS
Increase of Liabilities
Increase of Capital
Income
Other Income

(b) The asset merchandise has been acquired; therefore an account entitled Purchases, or Merchandise Purchases, is established. Since Dan Ross paid cash, this account is credited for the decrease in that asset. A question may arise as to why this transaction is classified as one that affects capital since apparently it represents only an exchange of assets. Admitting that the Purchase account presents some difficulty of classification, it is believed advisable to introduce it under the title "Purchases." The reason for this is that a nominal

element in Purchases is closely connected with the sales transactions, and therefore must be taken into consideration before the gross profit from a sale of merchandise can be determined. This account automatically becomes a mixed account as soon as a merchandise sale is made. Postings from the above entry will be found in Section 17 of this text.

10. SALES OF MERCHANDISE

Transaction No. 7

On January 10 merchandise is sold to Simon Young for $500 cash.

(Journal - Page 2)

				Dr.		Cr.	
		-10-					
		Cash	1	500	00		
		Sales	14			500	00
		Sale of merchandise to Simon Young,					
		per Sale Invoice No. 1591.					

Comment

(a) Dr. INCREASE OF ASSETS
Decrease of Liabilities
Decrease of Capital
Expense
Deduction from Income

Cr. DECREASE OF ASSETS
Increase of Liabilities
Increase of Capital
Income
Other Income

(b) Cash is debited because that asset is increased. Dan Ross, the proprietor, has increased his capital in the form of more net assets. Instead of crediting Capital directly we credit the nominal account Sales.

Inasmuch as many concerns derive the greater part of their income from profits on sales of merchandise, it is important that the accounting procedure relative to this type of transaction be carefully analyzed. The sale of merchandise results in an increase to the asset Cash and a credit to the account "Sales." This credit to Sales is justified because the selling price is treated for the time being as income. However, a sale differs from other income transactions in that it involves the surrender of ownership in the asset merchandise. This exchange of ownership may be considered an expense of making the sale which, under the usual method employed in accounting for retail sales, is not recorded until the end of the accounting period.

The true analysis of the sale transaction as to its effect on assets, liabilities, or capital undoubtedly is: an increase in assets (debit) offset by a decrease in the asset merchandise and an increase of capital for

the gross profit (credits). The gross profit is considered as income for the service of handling goods. The journal entry indicated by this analysis would be:

Dr. Cash or Customer's account	(Selling Price)	
Cr. Merchandise Purchases		(Cost of Goods)
Cr. Income from Sales		(Gross Profit)

This method may be used when it is practicable to keep a record of both the cost and selling price of each article or each lot of goods. However, in many instances this is not a practical method, since information as to the gross profit on each sale is not desired.

As a rule it is considered sufficient to record the total selling prices of goods sold during a period and, at the end of the period, to record the total cost of the goods sold. The accounts are kept on the theory that the entry recording sales is an increase of assets offset by an increase in capital (income) in the amount of the selling price. The expense element, cost of goods sold, will be recorded at the end of the period. For example:

Cash		Purchases	Sales
Balance	$250:	$800:	:Cash (A) $500
Sales (A)	500:	:	:

At the time the sale is made, a part of the asset value represented in the merchandise Purchases account is converted into the expense element, cost of goods sold. Thus Purchases becomes a mixed account containing the real element cost of goods on hand, or inventory, and the nominal element cost of goods sold. (In this explanation the opening inventory of Dan Ross will be ignored for sake of clarity.)

To illustrate the procedure followed at the close of the period, assume that no other purchases and sales are made. A physical count shows that goods on hand are worth $450 at cost. Therefore, the cost of goods sold must be $350 ($800 - $450). In order to leave the Purchases account with a balance representing the nominal element cost of goods sold, an entry (B) is made transferring the value of goods on hand to the Merchandise Inventory account (real). The nominal element is transferred (C) to Profit and Loss along with the income element of Sales (D), making the balance in Profit and Loss the gross profit realized, $150:

Purchases		
$800:	Inv. (B)	$450
:	P&L (C)	350

Sales		
P&L (D)	$500:	(A) $500

Merchandise Inventory	
(B)	$450:

Profit and Loss	
Cost of	Sales (D) $500

TYPES OF ACCOUNTS

Text No. 4

In actual practice, numerous sales and purchases would have occurred during a period but the principle is the same. At the end of the period the Sales account shows the total selling price of goods sold and the Purchases account shows the total cost of merchandise purchased and available for sale. After the real element of Merchandise Inventory is removed from the Purchase account, the nominal element of cost of goods sold is offset against Sales to determine gross profit realized. At the time of sale, however, nothing need be done other than to record the selling price.

Transaction No. 8

On January 12 Dan Ross sells merchandise to Amos Jones for $500 on terms of 2/10-n/30, meaning 2% discount for cash within ten days or the billed amount, net of any merchandise returns or allowances, due in thirty days.

(Journal - Page 2)

				Dr.		Cr.	
		- 15 -					
		Amos Jones	15	500	00		
		Sales	14			500	00
		Sold merchandise on open account, terms 2/10-n/30, per Sales Invoice No. 16$3.					

Comment

Amos Jones is debited because his promise to pay for the goods is regarded as an asset--an account receivable. Sales is credited for the income as in Transaction No. 7

11. FREIGHT AND CARTAGE INWARD

On January 14 Dan Ross received a shipment of merchandise from the Mercer Supply Company billed at $350, terms 2/10-n/30. Freight paid on this shipment was $10.

(Journal - Page 2)

				Dr.		Cr.	
		- 14 -					
		Purchases	13	350	00		
		Mercer Supply Company	16			350	00
		Invoice No. 703.					
		- 14 -					
		Freight and Cartage In	17	10	00		
		Cash	1			10	00
		Freight on above shipment.					

Comment

(a) The merchandise Purchases account is debited for the increase of assets. Since Dan Ross has become indebted to the Mercer Supply Company, an account payable must be opened with the creditor in order to record this increase in liabilities.

(b) The amount charged by the seller may not be the only cost connected with the purchase of merchandise. Other costs may be incurred in order to get the goods to the place of business, such as freight, express and drayage, import duties, weighing and inspection charges, etc. Such items could be debited to the Purchases Account inasmuch as they are considered part of the cost of the asset merchandise, but it is customary to have a separate record of these costs, Freight, express, and drayage inward may be included in one account. Note that Freight and Cartage In is debited above for the reason that there is an increase in assets (cost of merchandise purchased). Cash is credited for the amount paid out.

12. SALES RETURNS AND ALLOWANCES

Transaction No. 10

On January 16 Ross allowed Amos Jones credit for the return of $50 worth of goods sold to him January 12.

(Journal - Page 2)

		- 16 -						
		Sales Returns and Allowances	14	50	00			
		Amos Jones	15				50	00
		Credit for returned merchandise against Invoice No. 1673.						

Comment

(a) When merchandise is returned by a customer to be applied on account, or an allowance is made reducing the original selling price, an entry is made in the journal debiting Sales Returns and Allowances for a deduction from income and crediting the customer for a decrease in the asset account receivable. When goods are returned, there is simply a cancelation of the sale, while an allowance for damage, defect, or mistake is a reduction of the original selling price. If these items are numerous, it may be desirable to have separate accounts for returned Sales and for Sales Allowances. While returns and allowances could be debited directly to Sales, it is usually desirable to have the information in a separate account which is an offset to the income account "Sales".

(b) Note that in the case of a returned sale, the merchandise on hand is increased by the return, and cost of goods sold is correspondingly decreased.

Inasmuch as an entry has not yet been made for the cost of goods sold, these facts may be ignored. When physical inventory is taken, all goods on hand will be counted, including those returned, and cost of goods sold correctly computed.

13. PURCHASES RETURNS AND ALLOWANCES

Transaction No. 11

On January 17, Dan Ross received an allowance of $50 for defective goods in the shipment received January 14 from the Mercer Supply Company.

(Journal - Page 2)

		- 17 -					
		Mercer Supply Company	16	50	00		
		Purchases Returns & Allowances	13			50	00
		Allowance for defective goods sold under Purchase Invoice No. 703					

Comment

When goods are returned to a creditor, or allowance is made by the creditor on merchandise purchased, the account payable is debited for the decrease in liabilities and the Purchases Returns and Allowances account credited. If goods are returned, the asset merchandise is decreased. Here an allowance was made reducing the cost of merchandise purchased. This brought about a decrease in asset values. Further comment would be similar to that given for Sales Returns and Allowances.

14. SALES DISCOUNTS

Transaction No. 12

On January 20 Amos Jones paid $441 in full settlement of his account, taking a $9.00 discount, in accordance with the terms of sale.

Text No. 4

(Journal - Page 2)

		- 20 -					
		Cash	1	441	00		
		Discounts on Sales	18	9	00		
		Amos Jones	15			450	00
		Account in full less discount allowed.					

Comment

(a) The seller frequently offers the purchaser a discount for cash payment within a limited time from the date of invoice in order to induce the purchaser to settle promptly. According to one theory, discounts on collections for sales are regarded as an expense of the period when allowed. We have therefore established the nominal account "Discounts on Sales" to record this expense.

(b) This is a compound transaction: First, assets are decreased due to the customer's open account being closed; second, assets are increased because of the incoming cash; third, there is a decrease in capital for the discount allowed because the decrease in asset accounts receivable is greater than the increase in the asset Cash.

15. PURCHASE DISCOUNTS

Transaction No. 13

On January 23 Dan Ross sends the Mercer Supply Company a check for $294 in settlement of their invoice of January 13, taking a 2% discount as agreed.

(Journal - Page 2)

		- 23 -					
		Mercer Supply Company	16	300	00		
		Cash	1			294	00
		Discount on Purchases	19			6	00
		Account balance in full less 2%					

Comment

A discount on payment for purchases may be considered the converse of sales discount as explained in the preceding transaction. Under this theory discounts taken are considered income. Notice that the decrease of liabilities is greater than the decrease in the asset Cash; therefore capital is increased by the amount of the discount.

16. OPERATING EXPENSES

Transaction No. 14

On January 25 Ross paid $120 for insurance for the year, the policy having been effective as of January 1, 1944.

January 25, 1944 (Journal - Page 3)

				Dr.	Cr.
		Insurance	20	120 00	
		Cash	1		120 00
		Premium on policy 200 for the year 1944.			

Comment

The amount paid for insurance is debited to an account primarily regarded as nominal although in fact at this date the premium represents expense only for the insurance protection already received and an asset value in the form of unexpired insurance. Had payment been made at January 1, the debit would be entirely for an increase in assets. Cash is credited for the disbursement reducing assets.

Transaction No. 15 Sales to Customers

On January 26 merchandise was sold to customers for $750.00 cash.

(Journal - Page 3)

				Dr.	Cr.
		- 26			
		Cash	1	750 00	
		Sales	14		750 00
		Sales of merchandise for cash per daily sales record.			

Comment

See prior transaction regarding the sale of merchandise.

Transaction No. 16

On January 28 Ross paid the Daily News $60 for advertising printed in the local newspaper.

(Journal - Page 3)

				Dr.		Cr.	
		- 28 -					
		Advertising	21	60	00		
		Cash	1			60	00
		Advertisements in Daily News, Week of January 20, 1944.					

Comment

The return from advertising is of an intangible nature rather than any form of property. Hence the decrease in asset cash results in a decrease in net worth that is classified as an expense. The account "Advertising" is debited to show the expense incurred, and cash is credited for the payment. While the liability to pay for the advertising existed prior to this date, if an expense bill is to be paid within the month expended, no entry ordinarily is made until the date of payment.

Transaction No. 17

January 30 Ross received a bill for store supplies purchased during the month $25, from City Supplies Company. This will not be paid immediately.

(Journal - Page 3)

				Dr.		Cr.	
		- 30 -					
		Store Supplies	22	25	00		
		City Supplies Company	8			25	00
		Supplies purchased on open account per Invoices Nos. 1492 and 1493.					

Comment

Supplies used are an expense, while unused supplies are considered an asset. Since supplies are primarily an expense item over a period of time, we may analyze this entry as an increase in liabilities that reduce capital for the expense incurred. If any store supplies are on hand at the end of the accounting period, an adjusting entry will be made removing the asset value from this expense account.

Transaction No. 18

On January 31, the clerk's salary $100 for the month is paid. Sundry expense bills such as telephone, light, etc. totaling $22 also are paid.

(Journal - Page 3)

	-31-				
	Salaries	23	100 00		
	Cash	1		100	00
	Clerk's salary for the month				
	-31-				
	General Expenses	24	22 00		
	Cash	1		22	00
	January, 1944, Telephone, $12.00,				
	Light Bill, $10.00, paid.				

Comment

These transactions represent a decrease in the asset Cash for expenses paid, therefore a decrease in capital for services received.

The General Expense account should be used only for miscellaneous expenses. Whenever a particular expense item occurs frequently, a separate account should be opened.

17. POSTINGS TO LEDGER ACCOUNTS

After posting all transactions, the ledger of the Dan Ross will appear as follows at the close of business January 31, 1944.

Cash (Page 1)

1944					1944			
Jan. 1	Investment	J1	1,000 00	Jan. 2	Fixtures	J1	100 00
7	Brown on Acc't		400 00	4	Burns on Acct	J1	250 00
10	Sales		500 00	9	Merchandise	J2	800 00
20	Jones on Acc't		441 00	14	Freight In	J2	10 00
26	Sales		750 00	23	Mercer Co.	J2	294 00
				25	Insurance	J3	120 00
				28	Advertising	J3	60 00
	(Bal. $1,335)			31	Clerk's salary	J3	100 00
				31	Gen'l expense	J3	22 00

John Doe (Page 2)

1944 Jan. 1	Balance	J1	500 00				

TYPE OF ACCOUNTS

Text No. 4

Frank Brown (Page 3)

1944					1944				
Jan.	1	Balance	J1	1'000'00	Jan.	7	Cash & note	J1	1'000'00

Notes Receivable

1944									
Jan.	7	Brown 30 days	J1	600'00					

Inventory (Page 4)

1944									
Jan.	1	Investment	J1	2'500'00					

Furniture and Fixtures (Page 5)

1944									
Jan.	1	Investment	J1	500'00					
	2	Showcases	J1	100'00					

Building (Page 6)

1944									
Jan.									
	1	Investment	J1	5'000'00					

Land (Page 7)

1944									
Jan.	1	Investment	J1	1'000'00					
	2	Lot Purchased	J1	500'00					

Victor Leeds (Page 8)

1944					1944				
Jan.	6	Note	J1	1'250'00	Jan.	1	Balance	J1	750'00
						2	Land	J1	500'00
				1'250'00					1'250'00

City Supplies Company

1944					1944				
Jan.					Jan.	30	Store supplies	J3	25'00

Sam Burns (Page 9)

1944					Jan.				
Jan.	4	Cash	J1	250'00	1944	1	Balance	J1	250'00

K

Text No. 4

Notes Payable (Page 10)

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
						1944					
						Jan.	1	O. C. White	J1	2 000	00
							6	V. Leads 60 d.	J1	1 250	00

Mortgage Payable

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
						1944					
						Jan.	1	C. R. Co.	J1	1 000	00

Dan Ross, Capital

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
						1944					
						Jan.	1	Investment	J1	7 500	00

Purchases

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
1944											
Jan.	9	Cash Purchase	J2	800	00						
	14	Mercer Company	J2	350	00						

Purchase Returns and Allowances

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
						1944					
						Jan.	17	Mercer Co.	J2	50	00

Sales

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
						1944					
						Jan.	10	Cash Sale	J2	500	00
							12	A. Jones	J2	500	00
							26	Cash Sale	J3	750	00

Sales Returns and Allowances

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
1944											
Jan.	16	A. Jones	J2	50	00						

Amos Jones

Date		Explanation	F	Amount		Date		Explanation	F	Amount	
1944						1944					
Jan.	12	Mdse. 2/10-n/30	J2	500	00	Jan.	16	Return	J2	50	00
							20	Acc't. in full	J2	450	00

TYPES OF ACCOUNTS

Text No. 4

(Page 16)

Mercer Supply Company

1944						1944					
Jan.	17	Allowance	J2	50	00	Jan.	14	Mdse.2/10-n/30	J2	350	00
	23	Acc't in full	J2	300	00						

Freight and Cartage In (Page 17)

1944											
Jan.	14	Cash	J2	10	00						

Discounts on Sales (Page 18)

1944											
Jan.	20	A. Jones	J2	9	00						

Discounts on Purchases (Page 19)

						1944					
						Jan.	23	Mercer Co.	J2	6	00

Insurance (Page 20)

1944											
Jan.	25	Ppd. for year	J3	120	00						

Advertising (Page 21)

1944											
Jan.	28	Cash Daily News	J3	60	00						

Store Supplies (Page 22)

1944											
Jan.	30	City Supplies	J3	25	00						

Salaries (Page 23)

1944											
Jan.	31	Clerk for month	J3	100	00						

General Expenses (Page 24)

1944											
Jan.	31	Tel. light etc.	J3	22	00						

TYPES OF ACCOUNTS

Text No. 4

Here the fundamental accounting equation appears to have undergone a change. Expressing the present condition of the ledger we find:

(Debits) Assets + Expenses = Liabilities + Capital + Income (Credits)

The change, however, is only apparent. Transposing the items we have:

Assets = Liabilities + Capital including (Income minus Expenses)

Income minus Expense is an increase or decrease of Capital; therefore the accounting equation of Assets = Liabilities + Capital still holds true.

18 TRIAL BALANCE

Dan Ross
Trial Balance January 31, 1944

		Dr.	Cr.
Cash	(Real)	$ 1,335	$
John Doe	"	500	
Notes Receivalbe	"	600	
Inventory	(Mixed)	2,500	
Furniture & Fixtures	"	600	
Building	"	5,000	
Land	(Real)	1,500	
City Supplies Company	"		25
Notes Payable	"		3,250
Mortgage Payable	"		1,000
Dan Ross, Capital	"		7,500
Purchases	(Mixed)	1,150	
Purchases Returns and Allowances	(Nominal)		50
Sales	"		1,750
Sales Returns and Allowances	"	50	
Freight and Cartage In	(Mixed)	10	
Discounts on Sales	(Nominal)	9	
Discounts on Purchases	(Nominal)		6
Insurance	(Mixed)	120	
Advertising	(Nominal)	60	
Store Supplies	(Mixed)	25	
Salaries	(Nominal)	100	
General Expenses	(Nominal)	22	
		$13,581	$13,581

Note that the total of the left-hand column (debits) equals the total of the right-hand column (credits). This proves that for every debit posted to the general ledger there has been a corresponding credit--the double entry [illegible].

bookkeeping principle. But it does not prove that the work is correct. If, for example, a debit item of $100 were posted to the debit side of the wrong account, the books would remain in balance regardless of the error. On the other hand, if this debit were posted to the credit side of any account the ledger would be out of balance by twice the amount, and the error would indicate that fact. Errors may be made without disturbing the equality of the two sides provided these errors were in like amounts and affect both debits and credits. When two such errors occur, they are commonly referred to as "compensating errors." If there is an equality of debit and credit totals, one may reasonably assume that there is no error.

Each account balance has been classified as real, nominal, or mixed. Building and Furniture and Fixtures, primarily real accounts, are regarded here as mixed accounts because they contain the nominal element of depreciation--the decrease in value attending use of property. Purchases, Freight and Cartage In, and Inventory are classified as mixed accounts because they contain the nominal element cost of goods sold and the real element cost of goods on hand. While Insurance and Store Supplies may be primarily nominal accounts, both are mixed in this case because they contain real elements--Unexpired Insurance and Supplies Inventory. In Text 5 we shall consider the adjustment of mixed accounts and the summarization of nominal elements into the net increase or decrease of capital from business operations.